COMMITTEE ON PLANNING AND BUDGET
Report on Impacts of the Unfunded Liability in the UC Retirement Plan on UCSC's Budget

To: Academic Senate, Santa Cruz Division:

At the October 20, 2010 Faculty Senate meeting, a resolution passed by voice vote that included the following:

> THEREFORE BE IT RESOLVED that the Santa Cruz Division of the Academic Senate requests that the Committee on Planning and Budget work with its university wide counterpart to have the employer contribution to the pension plan be increased as rapidly as possible without endangering the critical functioning of the University, so as to reduce the huge employer contributions that will otherwise be needed in the next decade. CPB is requested to report on the results of their efforts at the first meeting of the Academic Senate in Spring 2011.

AS/SCP/1646 CFW Resolution on the Unfunded Liability of UCRP: CPB Report

Summary

Employer and employee contributions to UCRP have resumed and are being ramped up year-by-year. Total contributions do not yet equal ongoing fund "normal" cost or the increment needed to restore the fund deficit. A plan has been developed in consultation with the Senate to restore the pension plan to 100% funding. The plan's implementation will take several years. Important factors largely beyond UC control include any future state contributions to UCRP and performance of the retirement portfolio. UCSC has budgeted $5 million ($1.4 million in 2009-10 and an additional $3.6 million in 2010-11) to cover the general fund cost of restarting UCRP contributions. Another $4 million will be budgeted in 2011-12, bringing the total employer costs to $9 million per year. In addition to contributions from general funds, units with employees paid from other fund sources must also contribute to UCRP.

Report

The university wide counterpart to CPB is the University Committee on Planning and Budget, or UCPB. CPB Chair Brent Haddad is a member of UCPB. Chair Haddad initiated and participated in several UCPB discussions on the employer contribution to the pension plan. This response focuses on the UC Retirement Plan (UCRP) only, and not the retiree health plan, another important part of UC's post-employment benefits.

Money entering a pension fund needs to cover money leaving the fund as well as any fund deficit. UCRP has a "normal cost" of 17.6% of covered payroll, or $1.4 billion per year. (Following phase-in of approved revisions to UCRP, the plan will have a normal cost of 15.1%.) UCRP also currently is underfunded (as of July 1, 2010) by $13.5 billion. The total value of the fund is $35-40 billion, depending on valuation method.

The goal of UC, endorsed by the Senate, is to restore the retirement plan for full funding and meet the annual normal cost on an ongoing basis. This cannot be done immediately because the deficit is too large. Instead, a multi-year plan has been developed to steadily increase contributions to the pension fund until they are higher than the normal cost (2018), maintain the higher contributions until the fund recovers, and then lower the contributions to the necessary level. This should restore the pension to 100% funding over the next roughly 25 years. The following steps are being taken:

1. Increasing employee contributions. The following schedule has been approved by the Regents:

Current contribution:	2% (redirection of the CAP – revenue neutral to employees)
As of July, 2011:	3.5%
As of July, 2012:	5%
Thereafter:	additional 1% per year (not yet approved)

The plan is for employee contributions to be half of employer contributions. The Faculty Senate has made clear its position that employee contributions should not rise higher than 7%. The UC Administration has not agreed to this cap on employee contributions.

2. Increase employer contributions. The following schedule has been approved by the Regents:

Current contribution:	4% of covered payroll
As of July, 2011:	7%
As of July, 2012:	10%
Thereafter:	additional 2% per year (not yet approved)

Models show the employer contribution reaching a maximum of approximately 18.6% per year in 2018. The employer contribution remains at this level for roughly 17 years, and then lowers over several years to roughly 10%. The peak employer contribution plus the employee contribution will exceed the normal cost and will be used to replenish the fund.

The current UCSC employer contribution based on 4% of its own covered payroll is over $5 million. (2010-11). UCSC will need to budget an additional $4 million per year to increase employer contributions to 7% of payroll in 2011-12. There will be additional contributions to the retirement plan from other fund sources, such as researchers paid from federal grants. The overall contribution from all funds will be $15.5 million at the 7% (July, 2011) level.

Allocating funds to the retirement plan is prudent and mandatory, but it also represents a “new” cost to the campus budget. By way of comparison, the current expected state funds budget cut to UCSC for 2011-12 is roughly $15 million. So at the same time the campus is budgeting for increased contributions to UCRP, it is also budgeting for cuts in the state contribution to UC.

Both trends reduce the flexibility of campus budgets.

Funding for the employer contribution comes from campus central funds and is a mandatory cost. The growing cost over time is included in campus budget projections in the item "Required Cuts and Obligations."

The anticipated 18.6% maximum employer contribution could be increased or decreased by any of the following:

- Better or worse than expected performance of the fund portfolio. Some portfolio growth is expected and built in to planning models (7.5% per year). A risk profile of the portfolio is also specified. The existing risk profile is generally conservative and has not been adjusted in an effort to increase returns. There is wide fluctuation in annual return on the portfolio. Since the portfolio is not as large as it should be (currently roughly three-quarters as large), years with strong return don't have as large an influence as they might, and vice versa. The rebound in the stock market since 2009 has contributed enough surplus funding to stop the growth in the funding gap as contributions have ramped up, but has not appreciably narrowed the gap. For details, see pp. 8-9 of the *UCRP and GEP Quarterly Investment Risk Report*, Feb. 22, 2011. Available at:

  http://www.ucop.edu/treasurer/invinfo/investment_info.html

- Low-interest loans to the portfolio that generate higher investment returns. This strategy is being pursued with the lending of $2.1 billion to UCRP, some from other UC fund sources (STIP) and some from commercial lending markets. It is expected to reduce the maximum employer contribution by roughly 1.4% (from 20% to 18.6%). This is because the interest rate on the borrowed money is expected to be significantly lower than the rate of return the funds will have in the retirement portfolio.
- Restarting of state contributions to the retirement plan. This is a major point of UC budget advocacy with the state legislature. There has been no state contribution since the early 1990s.
- Reduction or increases in the cost of benefits. This can occur due to plan changes or employee demographic changes (average age at hire or at retirement). Plan changes have occurred that will slightly reduce the long-term "normal cost" of the pension plan. The Academic Senate has argued that pension reductions should be viewed in the context of overall compensation, which currently lag behind competitor institutions.
- Change to expected ratio of active employees to retired employees. Currently the ratio is lowering as retired employees increase in number relative to working employees.
- Changes to the level of employee contribution.
- Faster ramp-up of employer and employee contributions. Employer contributions have resumed and are ramping up year-by-year at roughly 2% per year plus 1% per year increases in employee contributions. A faster ramp-up would reduce the ultimate maximum contribution but would further compromise current university budgets and employee take-home pay.

Additional information can be found at:

- Website on the future of UC Retirement Benefits (March 23, 2011 posting)
  http://universityofcalifornia.edu/sites/ucrpfuture/
  - Note: "Read the complete details of the Regents action" that focuses on Item F12 (March 15, 2011)

Respectfully submitted,

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